



A bridge linking housing research and practice

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Untangling the Sources of Mortgage Closing Costs

The myriad mortgage loan costs and fees encountered at a typical real estate closing leave many homebuyers feeling overwhelmed. To help borrowers more easily compare loan costs, Congress passed the Real Estate Settlement Procedures Act of 1974 (RESPA) to increase competition and transparency in real estate lending. Until now, HUD, the cabinet-level agency responsible for enforcing RESPA, has been unable to measure how effectively the Act has met these goals. A new study commissioned by the Office of Policy Development and Research uses 7,560 fixed-rate, 30-year mortgages insured by the Federal Housing Administration, fee data from HUD-1 settlement statements, and census data to examine homebuyers' experiences. The resulting report, *A Study of Closing Costs for FHA Mortgages*, provides insight into the fees and closing cost variations paid to lenders and mortgage brokers, real estate agents, and title companies.



Closing costs vary widely, depending on the loan source, loan complexity, and title and real estate agent fees, as well as buyer education and race.

Mortgage Brokers Charge a Premium

Fees paid to mortgage lenders and brokers add significantly to homebuying costs, with total origination and closing costs averaging \$3,400, or 1.3 times the average \$2,550 downpayment made by homeowners. Wide variation in costs exists between lender types (brokers and direct lenders, such as banks and other depository institutions), with brokered loan fees exceeding direct lender loan fees by \$300 to \$425.

Although loan fees were legitimately tied to lender risks—as measured by variables such as loan amount, property value, and the borrower's credit score—price discrimination has been known to occur. Loan fees are highly correlated to race and education characteristics, with African-American and Latino borrowers paying an average of \$415 and \$365 more, respectively, than other borrowers.

contents

- HECM Program: Coming Into Its Own **3**
- Energy Efficiency Inside and Out **4**
- Every Picture Tells a Story:
Data Images of Subsidized Households **7**

Untangling the Sources of Mortgage Closing Costs continued from page 1

Being more educated, or at least *appearing* to be more educated, gave homebuyers an edge during loan closing. On average, homebuyers in census tracts that have more college-educated adults paid \$1,100 less than those buying in census tracts with no college-educated adults.

Loan Complexity Adds Cost

More complicated loan transactions result in higher total loan costs for borrowers. Loans containing yield-spread premiums (YSP), discount points, and seller contributions to closing costs elevate total borrower costs.

In a competitive market, borrowers expect clear trade-offs when choosing between loan transactions, which may mean paying more upfront cash for lower interest rates or accepting a loan with a higher interest rate in return for lower upfront costs. However, the tradeoffs may be harder than expected for consumers to calculate. Research shows that borrowers saved only \$20 in upfront cash for each \$100 paid in YSP. Mortgage-brokered loans benefited the least, saving only \$7 per \$100 in YSP. Discount points followed a similar pattern, with borrowers of brokered loans seeing no savings. In comparison, bank customers paying points received \$65 for every \$100 in discount points paid. Borrowers also received less than a 100-percent return when sellers contributed to closing costs. For every \$100 a seller paid, the borrower got an average benefit of only \$50, with borrowers from banks and other depositories getting \$70 and brokered loans benefiting by only \$40.

"No-cost" loans appear to offer the most competitive terms for borrowers, allowing consumers to compare loans based on interest rate without having to determine the best tradeoff of upfront costs versus rates. Although no-cost loans may not be the least expensive option when considering the higher interest rate, borrowers with no-cost loans paid \$1,200 less for loan origination services than borrowers who paid some lender/broker fees in cash. The no-cost loan market also appeared more competitive, in that costs showed little or no relation to borrower education or race.

Title and Real Estate Agent Fees Add Costs

Title and real estate agent fees also added considerable costs to homebuying. Title charges averaged \$1,200 per loan, with higher title fees charged when



Improved disclosure of mortgage costs would allow borrowers to more easily compare and shop for loans.

fees to lenders and real estate agents were high, even though these costs have little correlation with each other. The large disparities in title fees, along with strong correspondence to borrower race and education, suggest that title services are neither competitive nor transparent.

Most real estate agent fees (76 percent) were equal to 6 percent or less of house value, with the remaining 24 percent charging a higher rate. Agent fees were most closely linked to house value and downpayment (i.e., fees are less on home loans with lower downpayments) with no correlation to race and little correlation to education.

Improving Disclosure to Borrowers

Although this study focuses on data analysis, it is unambiguous in calling for better and clearer consumer information. Wide variations in costs between services and lenders, as well as price discrimination, indicate a less-than-competitive market. Better and more readily understandable disclosures would make it easier for borrowers to compare and shop for the lowest cost mortgage, while also eliminating price discrimination based on race and education. Continued monitoring of closing costs, title services, and other real estate services will also be necessary to achieve a more transparent and competitive residential mortgage market.

You can order a printed copy of *A Study of Closing Costs for FHA Mortgages* for a nominal fee or download a copy at no cost from the HUD USER website at www.huduser.org/publications/hsgfin/fha_closing_cost.html. 

HECM Program: Coming Into Its Own

The Home Equity Conversion Mortgage (HECM) program, a Federal Housing Administration (FHA) initiative that insures reverse mortgages for elderly homeowners, is likely to grow dramatically over the next two decades as aging baby boomers produce an annual bumper crop of seniors newly eligible for the program. According to Harvard University's Joint Center for Housing Studies, the number of owner heads of households aged 60–69 will increase by 53 percent between 2005 and 2015. Will reverse mortgages become mainstream among this growing cohort of older consumers, helping them cope with everyday expenses, home improvements, or medical bills while aging in place? An analysis in the first-quarter issue of *U.S. Housing Market Conditions* (USHMC) suggests that this may be the case.

Starting as a pilot program in 1989, HECM (also known as the FHA reverse mortgage program) became permanent in 1998. Growth was slow at first. Annual numbers of HECM loans remained below 8,000 until 2002 and then began to rise quickly. In 2007, approved loans rose from 76,282 in the previous year to 107,367. In 2008, the number of approved loans is expected to reach 110,000, totaling over 390,000 loans since the program began.

HECM loans are designed to help elderly homeowners (many of whom find themselves house rich but cash poor) access the equity in their homes without having

to sell or move. A reverse mortgage converts home equity to cash, structuring the payouts to homeowners in various ways. Payments can be made in a lump sum, in monthly installments, or as a flexible line of credit. About three-fourths of HECM borrowers choose this last option. HECM borrowers make no repayment as long as at least one borrower resides in the home. Loan recipients or their estate must pay the full value of the loan—principal plus interest—to the lender after the last living borrower dies, sells, or moves away.

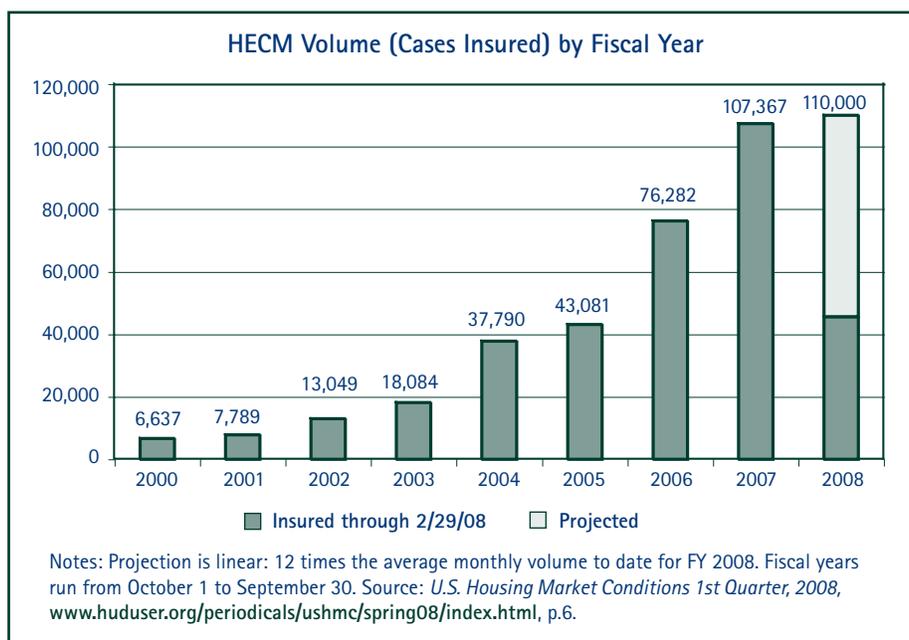
A commercial lender makes the HECM loan; the government's primary role is to insure it. FHA stipulates the amount of money to be lent in each case—a principal limit based on the borrower's age, the value of the home, and current interest rates. HUD also caps the loan according to a calculation based on either the value of the home or the FHA loan limit for the local area, whichever is less. HUD supports referral networks of housing counselors and requires a certificate of counseling from borrowers that confirms an understanding of how a reverse mortgage works and that less costly alternatives exist.

HECM loans offer significant advantages for both borrowers and lenders. Borrowers gain a government-guaranteed stream of income based entirely on their homes' equity; other assets, income, or debts are not considered. Unlike a commercial second mortgage or home equity line of credit, a HECM loan creates no

pressure for repayment during the home-owners' tenure. Income from HECM is tax free, although it may count against eligibility for some means-tested programs. FHA ensures that lenders will receive the full value of the loan at term regardless of any possible changes in property values, which lowers risk and makes better loan terms possible.

On the downside, a reverse mortgage is a relatively expensive borrowing mechanism. A reverse mortgage uses up the equity in a home, and interest continually accrues to the household's debt. Unlike a traditional mortgage,

continued on page 6



Many homebuilders—and an increasing number of homeowners—have come to view the whole house as an integrated system. The Partnership for Advancing Technology in Housing (PATH) applies this concept to home design, construction, and retrofitting by supplying research-based guidance organized around five action principles:

- Resource and waste management;
- Energy system integration;
- Resource-efficient plumbing;
- Good indoor air quality; and
- Low-impact development.

On their own, many of the available technologies consistent with these principles improve home energy efficiency. How these technologies can best work together to achieve ultimate cost savings will require continued research and refinement, even as they are implemented. Below, you'll find some of the methods, procedures, and equipment that enable the whole-house approach while maximizing energy and resource efficiency.

Managing Resources and Waste

Resource and waste management involves using durable building materials and construction methods that withstand the elements, minimize labor requirements, and reduce the amount of unused materials. Energy-efficient technologies that advance this principle with demonstrated results include insulating concrete forms (ICFs) and structural insulated panels (SIPs).

ICFs. ICFs are foam forms for concrete that remain in place after the concrete is poured, providing a highly insulated wall that possesses great strength. The completed wall consists of a 4- to 6-inch reinforced concrete core with about 2 inches of foam insulation on each side. The result is a solid concrete exterior wall that resists energy loss, drafts, and noise. Use of such wall systems may also enable reductions in the capacity of the heating and air conditioning systems because the homes are more heavily insulated and air tight.

SIPs. SIPs are engineered panels that offer structural framing, insulation, and exterior sheathing in a solid,

one-piece component. The panel, used for walls and roofs, commonly sandwiches a thick layer of foam between two layers of oriented strand board, plywood, or fiber-cement board. SIPs are precisely cut in standard sizes or to measure in the factory, thus reducing manufacturing waste. PATH field evaluations of SIPs document increased energy efficiency achieved through optimized thermal performance; indeed, utility bills were cut in half at one development in Dallas, Texas and reduced to \$48 per month in a home in Minneapolis, Minnesota. In both evaluations, Home Energy Rating System scores were strikingly better than comparable light frame homes.

Integrating Energy Systems

Well-designed buildings are correctly oriented relative to the sun's path, insulated, day- and electrically lit, and have properly sized HVAC systems. All of these factors help reduce overall energy demand while improving comfort and durability. Among the technologies that are consistent with these principles, PATH suggests high-efficiency equipment and tight ductwork installed within conditioned space, passive and active solar design to maximize the sun's energy, solar water heaters, photovoltaic roofing panels, ENERGY STAR®-qualified lighting, high-performance windows, and programmable thermostats. Three of these approaches are discussed below.

High-performance windows. Many high-performance window features improve home energy efficiency. Low-e (emissivity) coatings reduce energy loss, saving \$103 in energy costs for a test home in Boston, Massachusetts. Solar control windows allow more natural light to enter the home, reducing the need for artificial lighting, and helping to reduce heating and cooling costs—up to \$65 a year in one test conducted in Tucson, Arizona.

Programmable thermostats allow the homeowner to set HVAC systems to turn on and off automatically, and to adjust temperature settings to suit the user's schedule. According to ENERGY STAR, these devices can save as much as \$180 a year. A 2001 PATH field evaluation conducted in an energy-retrofitted home in Nevada demonstrated that simply adjusting the temperature setting for an automatic winter nighttime setback saved \$67 annually.

continued on page 5

Energy Efficiency Inside and Out *continued from page 4*

Compact fluorescent lights (CFLs). The U.S. Department of Energy (DOE) says that lighting accounts for nearly 15 percent of a household's electricity consumption. CFLs use 50 to 80 percent less energy than traditional incandescent bulbs and last much longer. A CFL lasts from 6,000 to 10,000 hours, compared with 750 to 2,500 hours for an average incandescent bulb. An 18-watt CFL used in place of a 75-watt incandescent bulb saves about 570 kilowatt-hours (kWh) over its lifetime; at 8 cents per kWh, that's equivalent to a \$45 lifetime savings from one bulb.

Incorporating Resource-Efficient Plumbing

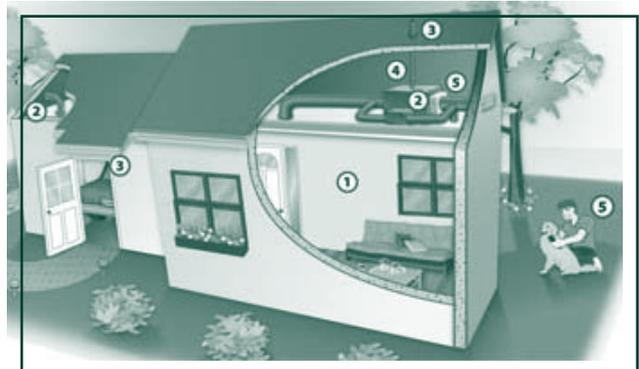
Resource-efficient plumbing technologies are easy to implement, meet current usage expectations, and reduce water consumption, which conserves both energy and resources. PATH-identified technologies that demonstrate this principle are cross-linked polyethylene (PEX) piping and tankless water heaters.

PEX piping. Traditional copper piping can be expensive, corrodes over time, and, because it's metallic, loses heat. An alternative to copper piping is cross-linked polyethylene or PEX—a high-temperature, flexible plastic pipe with a control center (manifold) requiring minimal fittings and no tees or elbows. In field evaluations, PEX has cost less to implement than copper piping, mainly because of reduced labor costs. Additionally, in a field evaluation in Lincoln, Nebraska, a PEX system delivered 100°F water to the furthest fixture in 15 seconds (compared with 32 seconds for a copper system), significantly reducing both water and energy consumption.

Tankless water heaters. Water heating accounts for approximately 14 percent of a household's average energy budget. Tankless water heaters eliminate the loss of energy from warmed water sitting in a tank. PATH field evaluations show that tankless heaters, which supply hot water on demand, shrink the energy consumption of a home's water heater by 10 to 20 percent. Builders and homeowners considering adoption of this technology should check to ensure compatibility of products with the existing power supply.

Ensuring Good Indoor Air Quality

Careful selection of materials and proper ventilation are essential to healthy interior environments. With the increased focus on energy efficiency over the past decade, less fresh air and fewer pollutants enter the



This PATH diagram suggests options for achieving a comfortable and healthier indoor environment: 1) materials with low VOCs; 2) ventilation, humidity control, and air filtration; 3) durable building envelope details; 4) sealed combustion appliances; and 5) occupant vigilance. <http://www.pathnet.org/sp.asp?id=13675>.

typical home and fewer air contaminants leave, resulting in poor air quality. Properly sized HVAC systems and whole-house strategies are needed to ensure that adequate filtration, ventilation, and air exchange exist inside the home. To be efficient, the HVAC system's design must fit the home, for which factors of heat loss, air infiltration through building openings, and heat gain are considered. PATH explains that, in this case, efficiency refers to longer operating periods that reduce both the number of on and off cycles and the demand on energy and equipment. PATH finds that ENERGY STAR-qualified HVAC equipment will further increase energy efficiency by 20 percent.

Minimizing the Impact of Development

Low-impact development reduces erosion and disturbance on the building site and preserves natural habitats as much as possible. Homeowners can advance the principles of low-impact development while reducing energy consumption by using trees and shrubs to provide shade and windbreaks for the home. According to DOE, shade trees can lower air temperatures by 9°F and improve the efficiency of air conditioners by as much as 10 percent. Trees and shrubbery also serve as windbreaks, lower wind chill, and create insulating air space near the home.

ToolBase Services says that the typical household spends \$1,000 to \$1,500 each year on utilities. When the principles and technologies described above are effectively applied in conjunction with other energy conservation practices, the result will not be additive savings. However, the whole-house approach can make a significant difference in what consumers get

continued on page 6

Energy Efficiency Inside and Out continued from page 5

for their energy dollar and can help builders sell more homes in sluggish or otherwise competitive housing markets. ENERGY STAR-qualified new homes are already 20 to 30 percent more efficient than other homes, and since January 3, 2007, federally built residential buildings have a 30-percent energy consumption reduction standard that needs to be met.¹

1. Energy Conservation and Production Act, 42 U.S.C. § 6834(a).

Information about these principles and technologies is derived from *The PATH Guide to Green Building* at www.pathnet.org/sp.asp?id=24934, ToolBase Services at www.toolbase.org, DOE at www.eere.energy.gov/consumer/your_home, and ENERGY STAR at www.energystar.gov. **HLI**

HECM Program: Coming Into Its Own continued from page 3

HECM loan interest is not tax deductible until the time of payoff. Also, owners of homes exceeding HECM value guidelines will be constrained by HUD's limits on the principal.

The recent housing crisis has heightened sensitivities concerning nontraditional mortgage arrangements. The *USHMC* analysis assures readers that HECM is financially sound, "subject to all the numerous laws and federal accounting guidance that govern the risk management and reporting for all government loan guaranty programs." HECM is designed to incur no credit subsidy (operating loss) and to use conservative assumptions on changes in property values, thereby bolstering the program's stability.

HECM-insured loans now dominate the reverse mortgage market, with a share ranging from 85 to 95 percent since 2006. The secondary market for HECM

loans has begun to broaden its investor base, which should mean lower borrowing costs and additional product innovations. Until 2006, Fannie Mae purchased nearly all HECM loans. Recently, however, Ginnie Mae launched a HECM-backed security. In addition, since 2007, HUD has allowed adjustable-rate HECM loans to be indexed to the London Interbank Offered Rate (LIBOR).

These developments, coupled with demographic-fueled demand, suggest that reverse mortgage lending — and HECM-backed loans in particular — will grow sharply over the next several years. The complete analysis is available at www.huduser.org/periodicals/ushmc/spring08/index.html. Free print copies of the report can be ordered by calling HUD USER at 800.245.2691, option 1. **HLI**

Orange County, California, the nation's fifth largest county and home to three of its busiest amusement parks, is the focus of a recent *Comprehensive Housing Market Analysis* (CHMA). Readers will find that, while sales in the market declined from June 2006 through June 2007, the price of existing single-family homes increased by 6 percent, to \$734,000. Additionally, the overall rental vacancy rate remained low (3.6 percent), despite a reported 6-percent rent increase during that same time period. This report describes economic, demographic, and housing inventory characteristics from 1990 to 2000, from 2000 through June 2007, and projections from July 1, 2007 to July 1, 2010. Similar CHMAs covering housing markets across the nation are available as free downloads at www.huduser.org/publications/econdev/mkt_analysis.html.

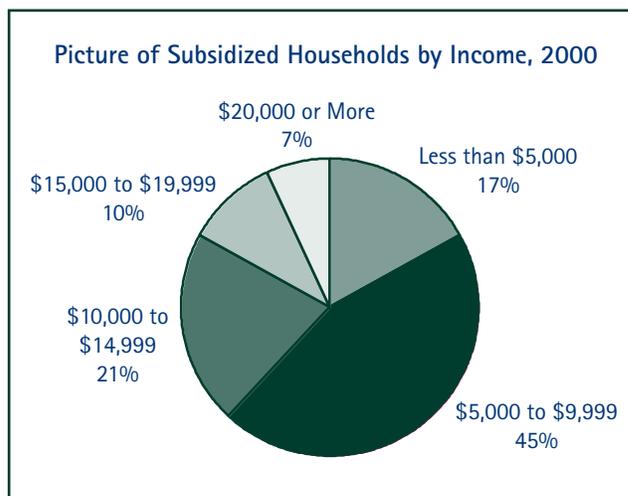


Serving as a tool for researchers and policy analysts, *A Picture of Subsidized Households (Picture)* summarizes data on nearly 5 million households living in HUD-assisted housing nationwide. *Picture* aggregates information by program at the national; metropolitan statistical area; state, city, census tract; and public housing authority levels. This comprehensive database on subsidized households is compiled from HUD's major data collection systems and made available by HUD's Office of Policy Development and Research.

Much of the data in *Picture* depict characteristics of participants in HUD's rental subsidy program. Without betraying confidentiality, the information includes tenant descriptors such as age, race, rent, income, household type (e.g., elderly, disabled, or families with children), and characteristics of both the housing unit and the surrounding neighborhood. For multifamily assisted housing and public housing, the database reports the total number of units, percentage occupied, number reported, household contributions toward rent and utilities, and federal spending per unit. Neighborhood characteristics include poverty, minority, and single-family ownership data.

Picture data exist for the 1970s, 1996, 1997, 1998, and 2000; a 2004 release is imminent. Beginning with *Picture 2000*, users can access the data with a web-based query tool. Researchers view the results of the query as a web-based report or as a comma-delimited file available for downloading and further statistical analysis. Users can also download the data and related documentation from the website.

HUD social science analyst Lydia Taghavi describes how to use the database in a recent issue of *Cityscape*, HUD's journal of policy development and research. Taghavi shows how analysts can use the census tract data in *Picture* to map the locations of assisted housing in a community. Another example demonstrates using *Picture* data to see the distribution of households participating in the housing choice voucher program by location and by neighborhood poverty rate, as well as to determine the dispersion of those households headed by elderly tenants.



In addition to income, *A Picture of Subsidized Households* provides information about HUD-assisted tenants' age, race, rent, household type, and housing units.

Other examples found in the research literature illustrate *Picture's* role in compiling reports for Millennial Housing Commission studies; studying the effects of segregation on neighborhood crime rates; pinpointing the relationship between welfare and housing assistance and the nature of their overlap; finding new models for public housing developments to replace old high-rise, high-density models; studying the impact of subsidized housing on the housing stock; and assessing changes over time in the characteristics of non-metropolitan public housing residents.

Although these applications are indicative of its versatility, *Picture* is not without limitations, which are explained in the online supporting documentation accompanying the data for each period (see www.huduser.org/datasets/assthsg.html). To read Taghavi's article, go to "HUD-Assisted Housing 101: Using 'A Picture of Subsidized Households: 2000'" in *Cityscape* (volume 10, number 1) at www.huduser.org/periodicals/cityscape/vol10num1/index.html, or order a print copy of the issue by calling HUD USER at 800.245.2691, option 1. **FLI**

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In the Next Issue of... ^{research} **works**

- The U.S. Green Building Council integrates the principles of smart growth, urbanism, and green building into the new LEED (Leadership in Energy and Environmental Design) standards for neighborhood design. These standards are being tested and pilot project experiences will be used to refine the rating and certification system prior to full implementation in 2009. *RW* will examine the content of the standards, review the certification process, and look at characteristics of the pilot projects.
- Among the features for greening American homes, garden roofs are emerging in residential construction as cost-effective, energy efficient, and environmentally friendly. These roofs are increasingly viewed as a means for countering climbing energy costs that challenge low- and moderate-income families. We'll explore roof garden attributes and illustrate their use in affordable housing communities.
- The Clara White Mission in Jacksonville, Florida, is the winner of the 2008 HUD Secretary's Opportunity and Empowerment Award for achievements in neighborhood revitalization, affordable housing, and economic development. The project supports workforce development and assists homeless members of the community, especially veterans and ex-offenders, with supportive services, while helping residents build marketable job skills. This article examines the 36-unit transitional housing project's offerings, as well as the broad community support and participation that helps its programs succeed.
- Hazards threatening the health of children have prompted nationwide efforts to assess and improve our living environments. Efforts to eliminate childhood lead poisoning have broadened to target childhood health problems caused by mold, allergens, pesticides, carbon monoxide, and radon that have at times been linked to substandard housing. Research conducted through HUD's Healthy Homes Initiative grant programs is finding that indoor air quality assessments and appropriate interventions can markedly improve the health and safety of the home environment. We'll look at some of these studies supported by HUD's Healthy Homes Initiative.

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